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Mr. John F. Bovenzi
Deputy to the Chairman and Chief Operating Officer
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, DC 20429

Dear Mr. Bovenzi: John

On April 11, Mr. Thomas M. Stevens, President of the National Association of REALTORS®, testified at the FDIC hearing on the application for federal deposit insurance for Wal-Mart Bank. I am writing on his behalf to supplement the answer to several questions asked by the panel.

Difference Between Financial and Commercial Affiliations

Mr. Doug Jones asked Mr. Stevens the following:

> What's the distinction between a bank today that would have an affiliation with an insurance company or securities company or some other financial affiliation? Why would it be different because it's a commercial concern versus these other affiliations?

Mr. Stevens explained one key difference during the hearing—that Wal-Mart's sheer size would expose a Wal-Mart Bank to unique risks. In addition, there are several other differences.

First, in enacting the Gramm-Leach-Bliley Act, Congress authorized banks to affiliate freely with securities and insurance firms, but not commercial firms, and sunsetted the authority for unitary thrift holding companies to own commercial firms. Congress considered proposals to authorize banks to affiliate with commercial firms and decided not to do so. The sunset of the unitary thrift holding company authority was partly in response to an application submitted by Wal-Mart for a federal thrift. Considering this recent congressional affirmation of the national policy against mixing banking and commerce, NAR urges the FDIC to defer consideration of the Wal-Mart application until Congress decides whether to close, or limit, the industrial loan company (ILC) loophole.

Another key difference is that securities and insurance firms are highly regulated entities, unlike commercial firms such as Wal-Mart. This regulation is designed to protect consumers and promote safe and sound operation. Affiliation of depository institutions with commercial firms is a much more risky structure than affiliation with other heavily regulated financial firms.

Risk to the Payment System

Ms. Sandra Thompson asked Mr. Stevens to respond to Wal-Mart's contention that the proposed Wal-Mart Bank would reduce risks to the payment system, not increase risk as NAR asserts. Wal-Mart's written testimony states:

> By sponsoring the highly predictable and low-risk payment transactions of Wal-Mart Stores, Inc., Wal-Mart Bank would have lower risk than other sponsor banks that serve thousands of retailers and businesses, representing a broad range of risk, including high risk entities.

We think there is significantly higher risk to the financial system whenever a bank is owned by a commercial firm and the bank's activities are, as a practical matter, limited to serving its parent. Wal-Mart's testimony underscores the reasons for our concerns. The bank's safety and soundness would be almost exclusively dependent upon the financial fortunes of only one customer—Wal-Mart. Such dependence violates the cardinal principle of banking—spreading risk through diversification. Diversification, not concentration, leads to safety. The federal bank regulators understand this well in the context of monoline banks. When a bank's sole mission is to process payments for its commercial parent, the risk to the bank, the financial system, and the deposit insurance fund is greater. Public confidence in a bank whose fate is inextricably tied to its parent's performance erodes quickly when the public believes the bank's parent is troubled. If Enron or WorldCom had owned a bank, we assume the bank would have joined its parent in failure, and the bank's losses would have spread throughout the financial system.

A Wal-Mart Bank also would increase risk to the payment system because Wal-Mart Stores would no longer use the services of <u>independent</u>, intermediary banks that today:

- serve as a check on any potential abuse by Wal-Mart because they provide payment system services only after conducting a thorough, independent credit review of Wal-Mart;
- guarantee to other banks in the system that payments Wal-Mart makes will be honored; and
- stand prepared to reimburse card-issuing banks for charge-backs that customers return through the payment system.

This process would break down if FDIC approves deposit insurance for a Wal-Mart Bank because it cannot be assured of exercising independent credit judgment if its parent were to face a financial crisis. The pressure on the bank to do what its parent told it to do would be enormous. In our view, the presence of independent directors on the bank's board would do little to counterbalance Wal-Mart's influence. And if Wal-Mart Bank initiated wire transfers or ACH debits and credits that Wal-Mart could not honor, the effect would be to transfer the risk of loss to the banking system. While Wal-Mart Bank would be legally obligated to reimburse banks down the line if there were a default, in such a case the bank itself would soon find itself in default as well and be unable to meet its obligations.

After reviewing the bank's revised capital calculations, we can only conclude that Wal-Mart anticipated that the FDIC shares our concerns with the risks that Wal-Mart Bank present to the deposit insurance fund and to the nation's financial system. Wal-Mart's last minute agreement to infuse an additional $100 million in capital to the bank is not sufficient to address the inherent conflicts of interest and risks that the Wal-Mart Bank presents. Accordingly, we again urge the FDIC to reject Wal-Mart's application for federal deposit insurance.

Please contact Jeff Lischer, NAR's Manager, Financial Services, 202.383.1117, if you have any additional questions.

Sincerely yours,

David A. Lereah
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